

Decision **DRAFT DECISION OF PRES. PEEVEY AND COMR. KENNEDY**

(Mailed March 26, 2004)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of SOUTHERN CALIFORNIA WATER COMPANY (U 133-W), for an order authorizing it to increase rates for water service by \$19,826,100 or 29.72% in the year 2003; by \$6,327,800 or 7.31% in the year 2004; and by \$6,326,200 or 6.81% in the year 2005 in its Region III Service Area and to increase rates for the General Office Allocation in all of its Customer Service Areas in this Application including: Arden-Cordova, Bay Point, Clearlake, Los Osos, Ojai, Santa Maria, Simi Valley and Metropolitan.

Application 02-11-007  
(Filed November 4, 2002)

**OPINION GRANTING PETITION TO MODIFY D.04-03-039****I. Summary**

On March 16, 2004, the Commission adopted Decision (D.) 04-03-039- which grants Southern California Water Company (SCWC) authority to increase rates in its Region III Service Area. The Commission found that SCWC violated Public Utilities Code Section 851 (§851) when it failed to seek the Commission's approval for its lease of water rights to the City of Folsom (City). Additionally, the Commission granted only retrospective approval of the voided lease agreement. The City seeks relief, as it believes that serious and immediate effects have occurred because the Commission did not grant prospective approval of the lease. As such, the City has filed a petition to modify D. 04-03-039's treatment of

prospective water rights purchased from SCWC. After a review of the new information provided the City, the Commission grants prospective approval of the leased water rights to the City.

## **II. Background**

By D.71889 issued January 24, 1967, the Commission authorized SCWC to transfer the City water system and 22,000 acre feet per year (AFY) to the City of Folsom. In November 1994 SCWC signed an agreement to lease approximately 5,000 AFY with the City. SCWC did not seek Commission approval under Public Utility Code §851 for the 1994 lease with the City. As a result, the Commission determined that SCWC violated §851 by not seeking approval for a water rights lease agreement that it entered into with the City (D. 04-03-039). Accordingly, the Commission fined SCWC \$180,000 for that violation. Moreover, the Commission determined that while the City acted in “good faith for value”, the City was entitled only to retrospective approval of the lease of water rights.

## **III. Discussion**

This petition to modify narrowly focuses on the issue of prospective water rights purchased by the City in an agreement with the SCWC in 1994. The Commission found in D. 04-03-039 that SCWC had violated §851 by failing to seek Commission approval to lease 5,000 AFY to the City in perpetuity. The City alleges that by not granting prospective approval to the lease, the Commission has caused immediate and severe harm. Specifically, by placing a cloud over the City’s right to the leased water, the Commission has made it difficult or impossible for the City to refinance on unfavorable terms over \$100 million of existing utility bonds; has placed the City in potential default under existing bond indentures; jeopardized planned expansion in the City’s East Area particularly including the planned development of a desperately needed hospital

and urgent care facility; and generally rendered doubtful various developments contained in the City's master plan for the East Area all of which assume the continuing availability of the leased water.

To address these concerns we revisit the plain words of the relevant statute. The relevant part of Section § 851 reads:

...any disposition of property by a public utility shall be conclusively presumed to be of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value...

D. 04-03-039 (page 53) concludes that the City is a good faith purchaser for value and therefore entitled to protection of its water rights on a retrospective basis. The City argues that the Commission, by not also granting a prospective approval of the leased water rights, is misinterpreting the language and intent of the statute.

The Commission, however, must reconcile the City's needs with its obligation to enforce § 851 in order to determine whether the transaction (in this case, the agreement between the City and SCWC for leased water) serves the public interest. To this end, D. 04-03-039 notes that there are several factors that the Commission must consider before granting § 851 approval. For example, the Commission must assess whether the proposed transaction will impair the utility's ability to provide service to the public. As such, SCWC must demonstrate that its water quality and supply problems can be addressed without the leased water supply (see Decision at page 44).

In D. 04-03-039 it was concluded that SCWC violated § 851 when it failed to gain the Commission's approval prior to entering into an agreement with the

City for leased water rights. As part of the remedy outlined in D. 04-03-039, the Commission voids the lease as to SCWC, and fines SCWC \$180,000.

In its petition to modify D.04-03-039, the City of Folsom has presented new evidence that heretofore has not been considered by the Commission. Ten years after the execution of the leased water rights agreement with SCWC, on March 16, 2004, the City first learned that the Commission had issued a decision voiding the leased water agreement. On March 26, 2004, the City filed a petition to modify D.04-03-039. Upon further review of the City's petition, we conclude that §851 protects the City's acquired interest in the water both with respect to the past and to the future notwithstanding our voiding of the lease as to SCWC. Accordingly, within 30 days from the issuance of this opinion, we direct SCWC to file a § 851 application for the leased water rights agreement with the City.

In view of this revision to our original decision, we also revise our order. We direct that the parties limit their responses to a discussion of the following topics:

1. How SCWC will obtain water sufficient to serve its customer base without the 5,000 AFY leased to the City
2. The proper accounting treatment of future lease revenues under the City lease.

#### **IV. Comments on the Proposed Draft Decision**

The proposed draft decision of President Peevey and Commissioner Kennedy in this matter was served to the parties in this proceeding in accordance with Public Utilities Code Section 311(g)(1) and Rule 77.7 of the Rules and Practice and Procedure. Due to the unforeseen and emergency nature of the issues addressed in this proposed decision, the comment period is shortened

pursuant to Section 311(g)(2) and Rule 77.7(f). Interested parties are required to file comments by 12:00 noon on Tuesday, March 30, 2004.

## **V. Assignment of Proceeding**

Michael R. Peevey is the Assigned Commissioner and David Fukutome is the assigned ALJ in this proceeding.

## **Findings of Fact**

1. In D. 04-03-039, the Commission found that SCWC violated §851 by not seeking the Commission's approval for its lease of water rights to the City.
2. As part of the remedy outlined in D. 04-03-039, the Commission voided the lease as to SCWC, and fined SCWC \$180,000.
3. In D. 04-03-039, the Commission granted only retrospective approval of the voided lease agreement.
4. As a result, the City has filed petition to modify D. 04-03-039 because of the serious and immediate effects that occurred because the Commission did not grant prospective approval of the water rights lease.
5. The City may have to refinance on unfavorable terms over \$100 million of existing utility bonds.
6. The City may be in jeopardy in being able to finance planned expansions of the City's East Area.

## **Conclusions of Law**

1. The City has demonstrated that there are severe and immediate impacts to its water supply and financial health because the Commission did not grant prospective approval of its leased water rights.
2. Pursuant to Government Code Section 11125.3 (a)(2), there exists a need to take immediate action in that the City of Folsom's water supply may be severely curtailed and its financial condition negatively impacted if the Commission does

not review its D.04-03-039 adopted March 16, 2004; this need for action came to the Commission's attention subsequent to the mailing of its April 1, 2004 agenda.

3. The Commission in D. 04-03-039 concludes that the City is a good faith purchaser for value in compliance with §851.

4. In this instant case, the Commission must reconcile the City's needs for the leased water rights to its obligation to enforce § 851 by determining whether or not the agreement between the City and SCWC for leased water serves the public interest.

5. After a review of new information, the Commission concludes that §851 protects the City's acquired interest in the water both with respect to the past and to the future notwithstanding the voiding of the lease as to SCWC.

## O R D E R

### **IT IS ORDERED** that:

1. Within 30 days from the issuance of this opinion SCWC is to file a § 851 application for the leased water rights agreement with the City.

2. We direct that the parties limit their responses to this application to a discussion of the following topics:

- a. How SCWC will obtain water sufficient to serve its customer base without the 5,000 AFY leased to the City
- b. The proper accounting treatment of future lease revenues under the City lease.

Dated \_\_\_\_\_, at San Francisco, California.